Message Text

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ACTION EB-07

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E.O. 11652: N/A
TAGS: GATT, ETRD
SUBJECT: GATT CONSUL: FRENCH STATEMENT ON DISC AND TAX PRACTICES

REF: GENEVA 6137

FOLLOWING ARE EXCERPTS AND SUMMARY OF MAIN POINTS IN FRENCH STATEMENT ON DISC AND TAX PRACTICES (GATT DOC C/97/ADD.1)

1. CONCEPT OF EXPORT ACTIVITY--STATEMENT DEFINES FIVE STAGES IN INTERNATIONAL TRADE ACTIVITY; MANUFACTURING STAGE, STAGE OF SALES, EXPORT STAGE WHEN PRODUCT LEAVES COUNTRY OF MANUFACTURE, IMPORT STAGE INTO ANOTHER TERRITORY AND DISTRIBUTION STAGE. ACCORDING TO FRENCH, DISC IS APPLIED AT SECOND STAGE, AND IS CLEARLY AN EXPORT SUBSIDY WITHIN THE STANDARD DEFINITION OF EXPORTS. WITH RESPECT TO THE FRENCH TAX PRACTICES, THE FRENCH MAINTAIN THAT: "THE PANEL, IN ORDER TO CONDEMN THESE TAX PRACTICES ON THE GROUNDS THAT THEY CONSTITUTE A SUBSIDIZATION IN FAVOUR OF EXPORT MUST HOLD THE VIEW THAT, WITHIN THE GATT MEANING, AND THEREFORE WITHIN THE MEANING OF ITS TERMS OF REFERENCE, THE CONCEPT
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OF EXPORT INCLUDES ALL FIVE STAGES..."

2. GATT DEFINITION OF EXPORT--THE FRENCH THEN ARGUE THAT THE ENTIRE CONCEPT OF GATT IS FOUNDED ON THE PRINCIPLE OF TRADE BETWEEN CUSTOMS FRONTIERS AND DOES NOT EXTEND BEYOND THOSE FRONTIERS AND THAT THE PANEL WENT BEYOND THIS "ACCEPTED" GATT DEFINITION IN RENDERING ITS DECISION:

"THUS, WHERE ONE DEALS WITH MOST-FAVORED NATION TREATMENT, MUTUAL CONCESSIONS, COUNTERVAILING AND ANTI-DUMPING DUTIES, EXPORT SUBSIDIES, TREATMENT OF IMPORTS OR EXPORTS, WHAT IS REFERRED TO IS ALWAYS INTERNATIONAL TRADE: THE GATT PROVISIONS DEAL WITH CUSTOMS PROCEDURS, FISCAL ECONOMIC OR ADMINISTRATIVE TRATMENT OF IMPORTS OR EXPORTS, DIRECT SUBSIDIES TO EXPORTED PRODUCTS, FISCAL ADJUSTMENTS AT THE FRONTIER, CUSTOMS VALUATION MATTERS, IMPORT AND EXPORT FORMALITIES. THE OBJECTIVE OF THE AGREEMENT APPEARS TO BE THE ELIMINATION OF DISCRIMINATION AND OBSTACLES TO TRADE BETWEEN THE CUSTOM FRONTIER OF THE EXPORTING COUNTRY AND THAT OF THE IMPORTING COUNTRY...."

3. IMPORTANCE AND THE CONSEQUENCES OF THE CHOSEN DEFINITION OF EXPORT ACTIVITIES--FRENCH ARGUE THAT ACCEPTANCE OF EXTENSIVE CONCEPT OF EXPORT ACTIVITY IS A DIRECT ATTACK ON THE DESTINATION PRINCIPLE AND, IF APPROVED BY THE GATT COUNCIL, "GOVERNMENTS WOULD NO LONGER BE FREE TO DETERMINE THE BASIC PRINCIPLES ON WHICH THEIR TAX SYSTEMS WILL BE BASED, WHEREAS AUTHORITY TO RULE TAX MATTERS IS A BASIC COMPONENT OF NATIONAL SOVEREIGNTY." THE STATEMENT ALSO ARGUES THAT THE EXTENSIVE CONCEPT OF EXPORT ACTIVITY AS DEFINED BY THE COUNCIL WOULD LEAD TO ECONOMIC DISTORTIONS THAT CANNOT BE REMEDIED. PERTINENT SECTIONS READ AS LIMITED OFFICIAL USE

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FOLLOWS:QUOTE
THIS CONCEPT DIRECTLY LEADS TO ECONOMIC DISTORTIONS, IN THE LIGHT OF THE ECONOMY OF THE PANEL'S REASONING. INDEED, AS HAS BEEN RECALLED ABOVE, THE GROUP LAYS DOWN AS A PRINCIPLE THAT, THROUGHOUT THE PROCESS WHICH IT SEEMS TO CONSIDER AS AN "EXPORT ACTIVITY", THE AGGREGATE TAX BURDEN SHOULD BE AT LEAST EQUAL TO THE BURDEN WHICH WOULD BE IMPOSED IF THEACTIVITIES IN QUESTION WERE CONDUCTED SOLELY WITHIN THE COUNTRY OF ORIGIN.

BUT ACTIVITIES FALLING WITHIN THE LAST TWO STAGES OF THE PROCESS DESCRIBED ABOVE - SUCH ACTIVITIES OCCURRING SOLELY WITHIN THE COUNTRY OF DESTINATION - MAY BE CONDUCTED IN THREE DIF-FERENT WAYS: BY A BRANCH OR A SUBSIDIARY ESTABLISHED IN THE COUNTRY OF DESTINATION, OF THE PARENT COMPANY IN THE COUNTRY OF ORIGIN MANUFACTURING THE PRODUCTS, OR BY UNDERTAKINGS IN THE COUNTRY OF DESTINATION TOTALLY INDEPENDENT OF THE MANUFACTURING COMPANY IN THE COUNTRY OF ORIGIN. IN ORDER TO AVOID ANY DISTORTION, THE SAME TAX TREATMENT - IN OTHER WORDS, ACCORDING TO THE PANEL, THE TAX TREATMENT OF THE COUNTRY OF ORIGIN - SHOULD THEREFORE BE APPLIED IN THE THREE CASES.

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IN ORDER TO AVOID ANY ECONOMIC DISTORTION RESULTING FROM THE TAX TREATMENT APPLIED IN THE FIRST CASE (I.E. IN THE CASE OF A BRANCH), THE COUNTRY OF ORIGIN SHOULD APPLY THE TREATMENT KNOWN AS THE "WORLD PROFIT" TREATMENT. IN OTHER WORDS, THE BASIS FOR THE TAXATION OF DOMESTIC UNDERTAKINGS SHOULD BE THE AGGREGATE RESULTS, WHETHER POSITIVE OR NEGATIVE, OF ALL THE BRANCHES OR ESTABLISHMENTS, WHEREEVER LOCATED THROUGHOUT THE WORLD. ALTHOUGH THIS RAISES A POLITICAL PROBLEM (SEE FURTHER ON), SUCH A SOLUTION CAN BE ENVISAGED AND IS IN FACT ALREADY APPLIED IN MANY COUNTRIES.
IN ORDER TO AVOID ANY ECONOMIC DISTORTION AS A RESULT OF THE TAX TREATMENT APPLIED IN THE SECOND CASE (I.E. IN THE CASE OF A SUBSIDIARY), THE COUNTRY OF ORIGIN SHOULD APPLY THE THREATMENT KNOWN AS THE "CONSOLIDATED PROFIT" TREATMENT. IN

OTHER WORDS, THE BASIS FOR THE TAXATION OF DOMESTIC UNDER-TAKINGS SHOULD BE THE AGGREGATE RESULTS, WHETHR POSITIVE OR NEGATIVE, OF ALL THE BRANCHES AND ESTABLISHMENTS AND ALSO OF ANY SUBSIDIARIES HAVING SEPARATE LEGAL PERSONALITY, WHEREEVER THEY MAY BE LOCATED THROUGHOUT THE WORLD. THE CONSOLIDATED PROFIT
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TREATMENT RAISES SUCH TECHNICAL PROBLEMS THAT NO COUNTRY AT
PRESENT APPLIES IT AS PART OF ITS ORDINARYLAW. UNLESS ALL
COUNTRIES ADOPT IT, WHICH SEEMS HIGHLY UNLIKELY TO HAPPEN,
THERE WOULD THEN BE A DIFFERENCE BETWEEN THE TAXATION OF A
BRANCH AND THE TAXATION OF A SUBSIDIARY, AND THEREFORE A
POSSIBILITY OF ECONOMIC DISTORTIONS OCCURRING.
LASTLY, IN ORDER TO AVOID ANY ECONOMIC DISTORTION AS A RESULT
OF THE TAX TREATMENT APPLIED IN THE THIRD CASE (ACTIVITIES BY
AN UNDERTAKING OPERATING AT ARM'S LENGTH WITHIN THE FOURTH AND
FIFTH STAGES), THE COUNTRY OF ORIGIN SHOULD BE IN A POSITION
TO TAX A FOREIGN UNDERTAKING CONDUCTING NO ACTIVITY WITHIN
ITS TERRITORY AND BEING FULLY INDEPENDENT OF ANY ENTERPRISES
IN THE COUNTRY OF ORIGIN. THIS IS LEGALLY ABSURD AND TECHNICALLY
IMPOSSIBLE. FROM THE LEGAL POINT OF VIEW, THE COUNTRY OF
ORIGIN HAS ABSOLUTELY NO BASIS WHATSOEVER TO ENABLE IT TO
EXTEND ITS TAX SOVEREIGNTY TO SUCH FOREIGN UNDERTAKINGS.
FROM THE TECHNICAL POINT OF VIEW, SUCH TAXATIO WOULD NOT BE
FEASIBLE. THUS, EVEN IF THE COUNTRY OF ORIGIN SUBJECTED ITS
DOMESTIC COMPANIES TO THE CONSOLIDATED PROFIT TREATMENT, THERE
WOULD STILL NECESSARILY BE A DIFFERENCE, IF ONE FOLLOWS THE
REASONING OF THE PANEL, SINCE THE SALE PROFIT MADE BY A
COMPANY OF THE COUNTRY OF DESTINATION OPERATING AT ARM'S LENGTH
ON THE MARKETING OF IMPORTED PRODUCTS COULD NEVER BE TAXED IN THE
COUNTRY OF ORIGIN, CONTRARY TO WHAT WOQQ WQWITH A
SIMILAR PROFIT REALIZED BY A BRANCH OR SUBSIDIARY. IF THE
TAX BURDEN IN THE COUNTRY OF DESTINATION WERE LESS THAN IN THE
COUNTRY OF ORIGIN, THIS WOULD CREATE AN OBVIOUS ECONOMIC
DISTORTION TO THE DETRIMENT OF INTEGRATED FORMS OF INTER-
NATIONAL TRADING (MARKETING BRANCHES AND SUBSIDIARIES).

THUS, IF AN EXTENSIVE CONCEPT OF EXPORT ACTIVITY IS MAINTAINED,
THE LOGIC OF THE PANEL'S REASONING INEVITABLY LEADS TO A SERIOUS
ECONOMIC DISTORTION BETWEENINTEGRATED MARKETING CHANNELS
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(BRANCHES AND SUBSIDIARIES) AND TRANSACTIONS BETWEEN THIRD
PARTIES OPERATING AT ARM'S LENGTH, UNLESS ALL COUNTRIES ADOPT
THE CONSOLIDATED PROFIT SYSTEM. AS THIS IS NOT THE CASE AT
PRESENT, THE PANEL WHICHCONDEMNS THE DISTORTION CREATED, IN
ITS VIEW, AT THE LEVEL OF THE BRANCHES AS A RESULT OF THE
FRENCH PRACTICES SHOULD ALSO CONDEMN THE SIMILAR DISTORTION
WHICH, IN THE LIGHT OF ITS REASONING, EXISTS AT PRESENT AT THE
LEVEL OF THE SUBSIDIARIES AS A RESULT OF THE PRACTICES MAINTAINED
BY ALL COUNTRIES THROUGHOUT THE WORLD. UNQUOTE

4. SEE REFTEL FOR USDEL COMMENTS.VANDEN HEUVEL

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